No. 84-569 (2)

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

PENNZOIL COMPANY,

Petitioner,

v.

PUBLIC SERVICE COMMISSION OF WEST VIRGINIA,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

BRIEF FOR THE PUBLIC SERVICE COMMISSION OF WEST VIRGINIA IN OPPOSITION TO PETITION

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November 13, 1984

QUESTION PRESENTED

Whether, under the Natural Gas Policy Act of 1978, 15 U.S.C. § 3301 *et seq.*, the price of gas Petitioner produces in West Virginia and sells to its retail customers in West Virginia is properly regulated by the Public Service Commission of West Virginia.

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OPINIONS AND ORDERS BELOW

The decision of the Supreme Court of Appeals of West Virginia is unreported and is reproduced as Appendix A to the Petition (Pet. App. 1a-2a).[1] The order of the Public Service Commission of West Virginia is reproduced as Appendix B to the Petition (Pet. App. 3a-25a).

JURISDICTION

The Supreme Court of Appeals of West Virginia entered its order on July 11, 1984. Petitioner filed an untimely request for rehearing which was denied on September 13, 1984. The Petition was filed on October 9, 1984. Petitioner asserts jurisdiction under 28 U.S.C. § 1257(3).

[1] References to the Appendix to the Petition for a Writ of Certiorari are cited as (Pet. App. ____).

STATUTES INVOLVED

This case involves the Natural Gas Policy Act of 1978, 15 U.S.C. §§ 3301 *et seq*. Relevant portions of the statute are reproduced in Appendix D to the Petition (Pet. App. 27a-29a).

STATEMENT

This case was previously before the Court in *Pennzoil Co.* v. *Public Service Commission of West Virginia*, ____ U.S. ____, 103 S.Ct. 3564 (1983). The Court vacated the judgment and remanded the case to the West Virginia Supreme Court of Appeals for further consideration in light of *Public Service Commission of the State of New York* v. *Mid-Louisiana Gas Company*, ____ U.S. ____, 103 S.Ct. 3024 (1983) ("Mid-Louisiana"). Both the Public Service Commission of West Virginia ("PSC") and the West Virginia Supreme Court of Appeals rendered subsequent decisions and Petitioner, Pennzoil Company, filed a second petition for a writ of certiorari.

1. Petitioner produces oil and gas in West Virginia and sells most of its West Virginia natural gas production at wholesale to Consolidated Natural Gas, an interstate pipeline. It also sells a small quantity of the natural gas it produces in West Virginia at retail to consumers in West Virginia through its local distribution division (Utility Division).[2] This case concerns the pricing of those local retail sales.

In a 1980 West Virginia rate proceeding involving the Utility Division's intrastate rates, Petitioner sought to have its own production, when sold by the Utility Division to retail customers, priced at the maximum lawful ceiling prices established by Congress in the Natural Gas Policy Act of 1978,

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[2] In addition to the gas that Pennzoil itself produces in West Virginia, Pennzoil purchases and resells gas from approximately 140 other independent producers in that State. It also operates a large gathering system through which it transports its own production as well as its purchased gas. The gas sold at retail to West Virginia customers by Pennzoil's Utility Division is identified by accounting entries from Pennzoil's production and transportation facilities to the Utility Division's distribution facilities.

15 U.S.C. § 3301 *et seq.* (NGPA). Petitioner claimed that such sales of pipeline produced gas constituted "first sales" within the meaning of Section 2(21) of the NGPA, 15 U.S.C. § 3301(21), and were thus entitled to the maximum price. The PSC rejected Petitioner's request in an order based in major part on the Federal Energy Regulatory Commission's interpretation of the "first sale" requirement. The West Virginia Supreme Court of Appeals denied Pennzoil's appeal and Pennzoil filed its first petition for a writ of certiorari.

The Court thereafter rendered its decision in *Mid-Louisiana* rejecting FERC's interpretation of the "first sale" requirement and holding that: (a) FERC must give "first sale" treatment within the meaning of the NGPA either to an intra-corporate transfer of natural gas between "divisions" of the pipeline at the wellhead, or to the downstream transfers of gas from the pipeline to a customer; (b) even where a "first sale" occurs, the producer may not be entitled to the maximum lawful ceiling price under certain circumstances. ____ U.S. ____, 103 S.Ct. 3036-3037. The Court remanded *Mid-Louisiana* to the FERC to determine whether first sale treatment should be provided at the intracorporate transfer or at the downstream transfer. ____ U.S. ____, 103 S.Ct. 3037.[3]

The Court subsequently granted Pennzoil's petition, vacated the judgment and remanded the case to the West Virginia Supreme Court for further consideration in light of *Mid-Louisiana*.

2. The West Virginia court, in turn, remanded the case to the PSC which concluded that *Mid-Louisiana* compels a ruling that "Pennzoil's own gas production in West Virginia, which is used for utility purposes, constitutes a first sale of gas" (Pet. App. 17a-18a, 22a). The PSC then determined that, for intrastate sales of gas produced by utilities within West Virginia, Section 602(a) of the NGPA, 15 U.S.C. § 3432(a),

[3]To implement the Court's decision in *Mid-Louisiana*, the FERC issued Order No. 391 which establishes that the "first sale" of production by pipelines and distribution companies occurs at the "intracompany transfer" point or the wellhead. 49 Fed. Reg. 33,849 (Aug. 27, 1984).

authorizes West Virginia to establish maximum lawful prices for a first sale lower than the ceiling prices contained within the NGPA (Pet. 18a, 22a).[4]

The PSC established rates in accordance with West Virginia law that requires such rates be just, reasonable, nondiscriminatory and based primarily on the cost of providing those services (W.Va. Code § 24-1-1 *et seq.*; Pet. App. 16a). The PSC found, as it did in 1980, that it had insufficient evidence to use a direct production cost of service study to establish a price for Petitioner's own gas production (Pet. App. 19a, 23a). Accordingly, the PSC used a proxy for cost based on the prices Pennzoil had paid non-affiliated suppliers during the "locked-in" period in issue, to determine a just and reasonable price (*id.*).

Pennzoil filed a petition for appeal with the West Virginia Supreme Court of Appeals, which denied the petition in an unreported order. After reviewing and "maturely considering"

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[4] Petitioner admits that West Virginia may regulate intrastate sales of gas (Pet. 11-12). Section 602(a) provides that "[n]othing in this chapter shall affect the authority of any State to establish or enforce any maximum lawful price for the first sale of natural gas produced in such State which does not exceed the maximum applicable lawful price, if any, under Subchapter I of this chapter."

The PSC concluded that its determination that Petitioner is not automatically entitled to the full maximum lawful ceiling rate of the NGPA is buttressed by the language of *Mid-Louisiana* and by Section 601(b) (1) (E) of the NGPA, 15 U.S.C. § 3431(b) (1) (E), which governs payments between pipelines and their affiliates (Pet. App. 18a-19a, 22a-23a):

> Paraphrasing the Supreme Court in *Mid-Louisiana*, just as Congress "undoubtedly intended pipeline producers to be treated in the same manner as pipeline affiliate producers" who are subject to market control through the application of § 601(b) (1) (E), so too must Congress have intended local distribution company producers to be treated in a similar manner, by subjecting them to an "affiliated entities limitation" test. This too suggests that Pennzoil should be allowed to recover for its gas an amount which "does not exceed the amount paid in comparable first sales between parties not affiliated" with Pennzoil. [Citation omitted.]

the entire record, the court denied the petition ruling that Pennzoil did not show that it was entitled to the relief it requested (Pet. App. 1a-2a).

DISCUSSION

Petitioner contends that the judgment of the Supreme Court of Appeals of West Virginia in this case presents substantial questions of nationwide impact concerning the proper interpretation of the NGPA. However, the lower court did not issue an opinion or expressly address the issues presented. Rather, in an unreported order, the court denied Pennzoil's petition for appeal and summarily affirmed the order of the Public Service Commission of West Virginia. The West Virginia court's decision is thus of little, if any, precedential value. Moreover, that decision is fully consistent with applicable decisions of this court and does not conflict with the decision of another state court of last resort or of a federal court of appeals. Indeed, the issue here has not been considered by any other court. Accordingly, review by this Court is unwarranted and the petition should be denied.[5]

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[5] There is no merit to Petitioner's argument (Pet. 13-15) that the West Virginia court's decision is inconsistent with this Court's earlier order remanding this case for further consideration in light of its intervening decision in *Mid-Louisiana*. Petitioner first claims (Pet. 14) that "the necessary implication" of the remand order is that the Court rejected the merits of arguments previously briefed by the PSC as to the applicability of Section 602(a) of the NGPA. Petitioner is thus arguing that the Court summarily reversed the West Virginia court. However, as Mr. Justice Brennan explained, the Court's "ordinary practice is not to reverse a state decision without oral argument." Mr. Justice Brennan, *State Court Decisions and the Supreme Court*, 31 Penn. Bar Assn. Q. 393, 403 (1960). The Court remanded the case simply to permit the state court to reconsider its decision in its ruling in light of the intervening *Mid-Louisiana* decision in view of West Virginia's reliance on the FERC order set aside in *Mid-Louisiana*. Such action reflects no view on the merits of the issues as to the applicability of Section 602(a) of the NGPA, and is, of course, common. *E.g.*, *Torrance* v. *Callenius*, 369 U.S. 658 (1962); *Kemp* v. *United States*, 369 U.S. 661 (1962); *Public Service Commission of the State of New York* v. *Federal Power Commission*, 361 U.S. 195 (1959); *Joines* v. *United*

1. Petitioner's primary argument (Pet. 15-24) is that the PSC had no authority under Section 602(a) of the NGPA, 15 U.S.C. 3432(a), to set a maximum lawful price for Petitioner's sale to its retail customers in West Virginia of gas it produces in West Virginia at a level below that established for "first sale" under the NGPA. Section 602(a) provides that "[n]othing in this Act shall affect the authority of any State to establish or enforce any maximum lawful price for the first sale of natural gas produced in such State which does not exceed the applicable maximum lawful price, if any, under Title I of this Act." Petitioner advances three reasons why it claims Section 602 is inapplicable here: (1) the "first sale" of gas was not in intrastate commerce; (2) West Virginia may exercise its authority under Section 602 only through action by the legislature, not by the Commission; and (3) action under Section 602 can only be by general rule and not, as here, by an order in a specific case. There is no merit to any of these arguments and none of them raises issues of general importance which warrant review by this Court.

First, contrary to Petitioner's argument, the sale of gas produced in West Virginia and sold to retail customers in West Virginia takes place in intrastate commerce.[6] This Court's

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States, 357 U.S. 573 (1958); *Cash* v. *United States*, 357 U.S. 219 (1958); *Amer* v. *Superior Court*, 334 U.S. 813 (1948); *Busey* v. *District of Columbia*, 319 U.S. 579 (1943).

Equally unmeritorious is Petitioner's claim (Pet. 14-15) that the West Virginia court made no attempt to comply with the remand order and provided no "reasonable explanation" for its decision contrary to the "duty" Petitioner states the Court imposed. This Court did not "impose a duty" on the lower court to explain itself; rather, it remanded to permit the state court to consider its decision in light of *Mid-Louisiana*. Moreover, Petitioner has presented no evidence to show that the West Virginia court acted improperly on remand. *See, Schlesinger* v. *Councilman*, 420 U.S. 738, 756 (1975); *United States* v. *Chemical Foundation*, 272 U.S. 1, 14-15 (1926).

[6] Section 602(a), in terms, is not limited to first sales in intrastate commerce but instead preserves state authority to establish or enforce maximum lawful prices for the first sale of gas "produced in such State" as long as the price does not exceed the NGPA ceiling prices.

decision in *California* v. *Lo-Vaca Gathering Co.*, 379 U.S. 366 (1965), and the other cases cited by Petitioner (Pet. 16, n.35) do not establish that a "sale" of gas produced, transported and sold to retail customers in a single state is in interstate commerce because the gas involved in the sale is subsequently commingled with gas sold in interstate commerce in the seller's lines. The issue in *Lo-Vaca, supra*, was whether a sale by a producer to an interstate pipeline could avoid regulation under the Natural Gas Act because of a contractual provision specifying, contrary to the actual flow of the gas, that it was to be utilized solely within the state or for the pipeline's own use. Here, all of the gas transferred to Petitioner's Utility Division remains in West Virginia. Moreover, in concluding that no artificial contractual restriction could be permitted to create an "attractive gap" in the regulatory scheme, the Court made clear that it was not holding that all situations of commingling would result in a jurisdictional transaction, 379 U.S. at 369-370.[7] *See, Public Service Electric and Gas Co.* v. *FPC*, 371 F.2d 1 (3rd Cir. 1967), *cert. denied*, 389 U.S. 849.

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[7] *Deep South Oil Co. of Texas* v. *FPC*, 247 F.2d 882 (5th Cir. 1957), *cert. denied*, 355 U.S. 930 (1958), which Petitioner characterizes as "particularly relevant" (Pet. 16-17, n.35), is of no help to Petitioner. There the court held that a sale of gas by a producer within the state to a company which processed the gas to remove the heavier hydrocarbons and then resold it to an interstate pipeline, was in interstate commerce. The court looked to the continuous flow of the gas in determining that the initial sale was in interstate commerce: "The fact that the sales are made at the wellhead is immaterial for the particular point at which the title and custody of the gas pass to the purchaser, without arresting its movement to the ultimate interstate destination, does not affect the essential interstate nature of the business." 247 F.2d at 887. (Citation omitted.) Here, of course, none of the gas transferred to Petitioner's Utility Division leaves the state of production.

Public Service Comm'n of Kentucky v. *FERC*, 610 F.2d 439 (6th Cir. 1979), the other case Petitioner claims to be "particularly relevant," also does not advance Petitioner's case. There the court held that the congressional policy expressed in the Natural Gas Act of 1938, 15 U.S.C. § 717, to provide an adequate supply of natural gas to the entire nation bars the Commonwealth of Kentucky from reserving a supply of natural gas for certain Kentucky residents and thus favor them over other Kentucky

There is no merit to Petitioner's argument that the FERC's order on remand, determining that the first sale of its own production by intrastate pipelines and local distribution companies as well as interstate pipelines takes place at the intracorporate transfer of the gas at the wellhead, rather than some downstream point, converts the sale into one made in interstate commerce not subject to the PSC's authority to set lower rates pursuant to Section 602 of the NGPA. It remains a sale of gas intended for and actually utilized by Petitioner's retail customers within West Virginia. To suggest it is in interstate commerce because this gas is transported for a short distance in pipeline facilities also carrying gas sold by Pennzoil in interstate commerce is as fictional an effort to avoid unwanted regulation (albeit here regulation by the state commission) as to attempt to contract out of federal regulation rejected in *Lo-Vaca*.

Second, Petitioner argues (Pet. 18-20) that Section 602 authorizes action only by states operating through their legislatures and not by state agencies. Nothing in the NGPA or its legislative history purports to specify how the state power reserved in Section 602 is to be exercised, or that state agencies with existing delegated state power may not continue to exercise their authority without additional action by the legislature. Petitioner's contention that the PSC does not possess the power under West Virginia law it asserted over Petitioner's sales of West Virginia production to retail customers in the state (Pet. App. 18-19) involves a construction of state law which this Court, under its established standards for review, will not entertain,[8] and ignores state regulation of Petitioner's retail gas rates for almost half a century.

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and non-Kentucky residents. In contrast, here the relevant congressional policy expressed in the NGPA is to allow states to set prices for the first sale of gas produced in the state at levels below the federal ceiling.

[8] Petitioner's argument is that the Commission has no jurisdiction to fix the rates of producers. It ignores the fact that Pennzoil is a "public utility" within the meaning of Section 24-2-1 of the West Virginia Public Service Commission Law with respect to the gas service it provides to retail consumers in the state. As such, its rates always have been subject to the regulatory authority of the Commission.

Third, Petitioner contends (Pet. 20-22) that the PSC, in regulating retail gas service to West Virginia residential and commercial users, may exercise its authority under Section 602 only by general rule and not in a specific proceeding involving the rates of a particular local distributor. Nothing in the language or legislative history of the Section dictates how the states or their agencies exercise their authority. Petitioner apparently surmises that Congress must have intended this in view of Congressional familiarity with regulation of interstate producer rates on an area or nationwide basis and with certain state laws prescribing ceiling prices for production therein. Congress was equally aware, however, that the rates for interstate and intrastate pipelines and local distribution companies are normally fixed on a "case-by-case" basis

2. Equally unpersuasive is Petitioner's effort (Pet. 22-24) to show a parade of horrors it believes may flow from the PSC's decision. Suffice it to say that the PSC's continued regulation of Petitioner's rates for gas produced and sold in West Virginia has caused no problem of general significance.[9]

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[9] The foregoing amply demonstrates that Section 602 of the NGPA preserves the PSC as the authority to regulate Petitioner's intrastate retail rates and that Petitioner's arguments to the contrary should fail. We emphasize, though, that even if Section 602 were not applicable, the PSC would have continuing authority to regulate Petitioner, for Congress has not clearly indicated its intent to preempt state regulation of intrastate gas pricing. *See, California* v. *Zook*, 336 U.S. 725 (1949); *Head* v. *Board of Examiners*, 374 U.S. 424 (1963).

Petitioner mistakenly argues (Pet. 24-27) that the PSC ruled that Section 601(b) (1) (E) of the NGPA, as well as Section 602, authorizes the PSC to regulate Petitioner's intrastate gas sales. The PSC ruled that Section 602 reserves its existing authority to regulate and to establish prices for the sale of gas at retail in West Virginia below the ceilings contained within the NGPA (Pet. App. 18a, 22a). It noted that Section 601 buttresses its conclusion that Petitioner is not automatically entitled to the ceiling prices (Pet. App. 18a-19a). The PSC cited Section 601 to suggest an alternative method of pricing and not, as Petitioner claims, as an alternative statutory authorization for its authority.

We note, however, that Petitioner's argument that Section 601(b) (1) (E) is not applicable to the price it can charge for its West Virginia gas production sold at retail to West Virginia consumers since the section

The PSC has no intent to regulate the wellhead price of nonutility producers in West Virginia. Rather, its jurisdiction is limited to utilities. Those utilities with intrastate production will continue to have the price of their gas determined by the PSC.

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in terms applies only to "interstate pipelines" does not advance its position. Section 601(b) (1) (E) is limited to "interstate pipelines" because the guaranteed pass through provisions of Section 601(c) of the NGPA, with which Section 601(b) operates in tandem, are limited to interstate pipelines regulated by the FERC under the Natural Gas Act. There is no provision of the NGPA which similarly provides that a state regulatory agency must pass through the costs of an interstate pipeline's or local distribution company's own production whenever it is within NGPA ceilings. The PSC thus correctly held that it could apply an "affiliated entities" test analogous to that of Section 601(b) (1) (E) in fixing the retail rates Pennzoil's Utility Division can charge to West Virginia customers.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

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